

THE LOCATION EFFICIENT MORTGAGE

The Location Efficient Mortgage (LEM) is an innovative mortgage product that is being developed and will be offered in the Los Angeles region, the San Francisco Bay Area and Chicago and its environs to home buyers interested in living in urban neighborhoods where households do not need to be car-dependent. The LEM is not presently on the market, but current plans foresee a pilot program beginning in late 1997.

The Natural Resources Defense Council (NRDC), the Center for Neighborhood Technology (CNT), and the Surface Transportation Policy Project (STPP) have joined together and created a partnership to demonstrate that the LEM facilitates home ownership in dense, transit-accessible central cities, considered "location efficient" communities.

Location efficiency recognizes the interdependence between housing, retail services, transportation, open space, cultural amenities and other features which make neighborhoods vibrant and active. The LEM recognizes that households in location efficient communities save money through "living locally." In 1994 the NRDC sponsored a study which found that residents in high-density residential communities drive far less than communities of lower densities. The LEM partners have developed a statistical model (based on Vehicle Miles Traveled vs. residential density, transit access, proximity to stores and jobs) showing the dollar savings per household in a location efficient area compared to an average household in a low-density suburb. This savings is then translated as increased borrowing power to purchase in a high-density area by increasing the mortgage level allowed by the standard mortgage formula banks now use. With the LEM, homebuyers need not be forced into distant low-density areas, where they must own a car and drive to every destination. The LEM levels the playing field, allowing people who want to live in location efficient areas a simple way to afford homes historically considered out of their reach.

For example, the study shows that a typical household in south Long Beach drives approximately 13,500 miles LESS per year than a household in Moreno Valley, a representative low-density suburb. That translates to approximately \$300/month in transportation cost savings for Long Beach households. Banks currently treat both areas equally, while the LEM takes these savings, or the *Location Efficient Value*, into account. (Applied to the suggested mortgage formula, \$300/month in transportation savings can equal more than \$33,000 in increased borrowing power.)

Newly created is the *LEM Advisor*, a computer software and mapping system than can calculate a family's annual and monthly Location Efficiency Value under a variety of situations and conditions. If a borrower chooses a Location Efficient Mortgage, inputs such as address, income, sale price, interest rate, downpayment and long-term debt are considered as the software program calculates whether the applicant qualifies for a mortgage. The *LEM Advisor* determines the density of the desired neighborhood and the level of transit access within a quarter-mile radius of the house. If the address or intersection is an area with a Location Efficient Value, the *LEM Advisor* immediately tells the underwriter whether the applicant qualifies for the loan using the Location Efficient Mortgage. The mortgage design allows a significant "stretch" in borrowing capacity, thereby enabling the applicant to comply with customary debt-to-income ratios while increasing the loan amount for which they can qualify.

The key provision of the LEM that sets it apart from other mortgage products is that the LEM will be linked to a quantified value for the relative advantage a home that is location efficient has over other

homes. Once the Location Efficient Value (LEV) is calculated, it can be used to determine one's total debt ratio as shown in the following formula:

$$PITI + LTD - LEV \leq 36\% \text{ INCOME}$$

when:

$PITI$ = Principal, Interest, Taxes, and Insurance

$INCOME$ = Gross Income before taxes

LEV = Location Efficient Value

In order to introduce the LEM as part of a test phase in the Los Angeles region, the San Francisco Bay Area and Chicago, NRDC and its project partners are bringing together lenders, mortgage insurers, for-profit and non-profit developers and others to subsequently operationalize the mortgage as a Fannie Mae-sponsored Alternative Underwriting Experiment. The process of establishing the configuration of the LEM and its various applications in these markets has now begun, but firm underwriting criteria have not yet been established. It is likely, however, that the LEM will be very much like other mortgage products currently available. Likely characteristics of the LEM will include:

- 30-year fixed rate mortgage for owner-occupied, 1-4 unit dwellings and condominium units;
- Interest rates determined by prevailing rates at the time of application or close;
- loan-to-value ratio (LTV) of up to 95 percent;
- Pre-application homeownership counseling will be required;
- Post-application counseling and reporting will be encouraged as necessary;
- Standard verification of employment and credit history will be required;
- Key household information reported annually to the LEM Program for research purposes only.

The LEM Partnership has started outreach with several banks in each targeted region to serve as lenders for the test and also anticipate the secondary market, including Fannie Mae and Freddie Mac, will become active partners in this venture. We are looking for other interested parties to join in this ground-breaking demonstration.

Looking toward the future we expect to expand the LEM program to other metropolitan areas throughout the country. We have already received inquiries from over twenty cities. Our goal is the eventual universal acceptance of the principles of location efficiency within basic underwriting guidelines.

The LEM is a core element of the National Partners in Homeownership Campaign and is endorsed by the President's Council on Sustainable Development. As part of a larger effort that looks at how cities can grow without putting undue strain on scarce resources and support services such as undeveloped lands, water and sewer lines, electricity and gas, the LEM encourages investment in location efficient neighborhoods by increasing location choices to the home buyer.

Long term, the LEM hopes to serve as a catalyst for promoting sustainable land use, increasing investment in public transit, and making cities and communities more livable as a whole. To be truly effective, of course, this effort must be a collaboration of government, bankers, developers, urban planners, environmentalists, community groups, and businesses. We are actively working to make that multi-interest partnership a reality.

If you are interested in working with us in the implementation of this new lending tool, please call Michael Fitts at the Natural Resources Defense Council 213.934.6900; or Donna Liu at 415.777.0220.